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JAPAN AND ASEAN: ASPECTS OF A NEW INTERDEPENDENCE

SUMMARY

The remarkable economic growth of the six members of the Association of Southeast Asian Nations in recent years has definite links to developments in their economic relations with Japan. The surge of Japanese investment in Southeast Asia following the appreciation of the yen in the second half of the 1980s was a major force in the region's economic expansion. Japan's growing manufacturing presence during this period helped build up the industrial base of many Asean nations, contributed significantly to the escalation of Asean exports and imports, and changed the composition of the region's trade flows. Yet even as recent Japanese investment in the region has tightened the ties between Japan and Asean, some have questioned the impact of this presence both on Asean countries and on the region's trade partners.

Southeast Asian nations no doubt will continue to vie among themselves and with other regions for Japanese investment. Yet Asean members are likely to have higher expectations for future investment as their plans for economic growth enter a more advanced stage. Moreover, as regional trade linkages increase in other parts of the world, Asean nations may try to help guide Japan's role as an economic leader in Asia.

Overview

Intensified trade tension between the United States and Japan has generated attention at times on Japan's expanding economic presence in Asia and particularly on the role Japan has played in the export-led growth of the countries that comprise the Association of Southeast Asian Nations — Thailand, Singapore, Malaysia, the Philippines, Indonesia and Brunei. Playing into concerns about Japan's increasingly dominant economic role is a sense in some corners that the United States is losing out on opportunities in Southeast Asia. Direct investment data are difficult to compare, and some analysts believe that the United States still has the largest direct investment position in some Asean nations. Yet the pace of U.S. investment in the region clearly is lagging

behind Japan's. In 1990 new Japanese direct investment proposals and approvals in Asean exceeded those of U.S. companies by more than four times.

Moreover, Japanese investment in Asean has boosted its trade with the region. In 1990 Japan exported almost $33 billion in goods to Asean, compared to nearly $19 billion in U.S. exports to the region. Analysts warn that the United States cannot afford to ignore the export opportunities the Asian market offers; Asean nations alone are home to 320 million people.

A related fear is that tighter Japanese trade and investment links with the region will lead to an Asian trade bloc that excludes the United States. Although some economists discount this possibility, their explanations may not be reassuring to American or Asean business and political leaders. Peter Petri of Brandeis University, for example, has attributed much of Japan's expanding trade with Asia to "triangular trade." This country's trade ties to Asia are unlikely to be severed because of the importance of trade flows in which "components and equipment are exported to Asian nations by Japan, and final products go from the Asian countries to the European and U.S. markets," Mr. Petri has said.[1]

Many in the United States and in Asean see problems in this type of trade pattern. Some analysts, for example, attribute the 1987-90 reduction in the U.S. trade deficit with Japan in part to Japan's expanded manufacturing presence in Asia. By moving assembly operations to third countries, they assert, Japanese industry has had a hand in "transferring export statistics from Japanese to other countries' trade figures and reducing the deficit attributable to Japan."[2] In addition to clouding the question of the U.S.-Japan trade imbalance, critics contend, this causes problems for Asean nations trying to keep trade surpluses in line or facing U.S. import quotas on certain products.

Distinct economic pressures contributed to the near doubling of Japan's foreign direct investment position in Asean between FY 1986 and FY 1990. The appreciation of the yen against the dollar after 1985 forced Japanese firms to find ways to remain competitive. Many moved their manufacturing operations to neighboring Asian countries in search of lower production costs as well as to increase their market share in host nations and in third countries. While recognizing the boon the Japanese presence has represented for Asean economies, some observers argue that Japanese government and business leaders should do more to ensure that such investment will result in long-term benefits for the region.

Developing Japan-Asean Economic Relations

While geographical, historical and cultural ties provide a strong foundation for Japan-Asean relations, the region's resources, markets and economic opportunities are key factors in a growing interdependence. In the 1960s and 1970s the economic relationship was rather imbalanced, with Japan relying on various Asean members for raw materials, as markets for growing Japanese exports of manufactured goods and as sites for new investment. By the late 1970s Asean discontent with what was perceived as Japan's increasing economic domination over the region led Tokyo to develop a new approach in which the emphasis was one of greater partnership with the six nations, accompanied by pledges of expanded economic assistance and increased imports from the region (see *JEI Report* No. 14A, April 10, 1987).

Since announcing its new policy toward Asean in 1977 Japan has been the region's largest provider of economic assistance. The importance of the region's economic stability to Tokyo is reflected in the consistently large share of Japan's official development assistance that Asean nations receive. In 1990 foreign aid amounting to $2.3 billion was directed to Asean, a sum that represented

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more than 33 percent of Japan's total ODA that year. Additionally, the Philippines, Thailand and Indonesia have been among the top 10 recipients of Japan's economic assistance for the last several years, and Malaysia frequently has been among the major recipients (see *JEI Report* No. 45A, December 6, 1991).

In recent years a significant share of Japan's foreign aid to Asean members has consisted of loans, a form of economic assistance that Tokyo sees as encouraging economic discipline among recipients and as being more appropriate to the region's development needs. The Ministry of Foreign Affairs' 1990 ODA report noted that "the development of the Asean economies will be accompanied by a shift in the content of ODA toward a primary emphasis on loans and technical cooperation. ... In the long-term future, they [the Asean economies] are also expected to advance beyond the need for ODA loans."

Recent Initiatives for Regional Development

Tokyo's aid approach for Southeast Asia provides a particularly clear example of the close relationship between the Japanese government and the private sector. The comprehensive nature of Japan's economic assistance to the region was emphasized by then Prime Minister Toshiki Kaifu during his 1991 trip to the region. Through its official development assistance to Asean, Mr. Kaifu noted, Japan was attempting to respond to the "diverse development needs of the recipient countries, fully mindful of the role played by trade, investment, and technology transfer. ..."[3] Underscoring the importance of foreign investment to Asean's economic growth, the government earmarked most official loans to the region for improvements in the economic infrastructure. In addition to improving the investment climate by developing the power, transportation and telecommunications systems of the recipient nation, such loans can open business opportunities for Japanese firms as well as assure investors that Tokyo sees the recipient as a safe bet.

Efforts by the Ministry of Foreign Affairs to develop the industrial bases of Asean members include the $2 billion Asean-Japan Development Fund, established in 1987 in part to provide low-interest loans for joint ventures in the region (see *JEI Report* No. 1A, January 6, 1989). AJDF also facilitates coordination between private Japanese capital and the government-backed Japan-Asean Investment Corp., established in 1981 to help boost Asean economic development.

Also in 1987 the Ministry of International Trade and Industry formally announced the New Asian Industries Development Plan, aimed in part at helping to develop the region's export industries (see *JEI Report* No. 14A, April 10, 1987). The plan attempted to address Asean concerns about the nature of Japanese investment in the region, which at the time was involved largely in natural resource development and a number of offshore assembly plants.

The New AID Plan's objective of boosting the region's production of manufactured goods met with some wariness both within Asean and in the United States. Fears that Japan would not increase its imports of Asean-produced goods led to questions about where the expanded volume of exports would be directed. The New AID Plan also has been a magnet for criticism that Tokyo has initiated a strategy to coordinate the development of Southeast Asia in line with Japan's economic objectives. Some critics contend, for example, that Japanese government officials have steered Asean industrial planners toward products that best fit Tokyo's plan for the region. David Arase of Pomona College presents a policy with more monetary overtones: "In essence, the policy objective is to mate Japan's capital surplus with that country's strength as an exporter of whole plants and capital goods to transplant into Asean those Japanese manufacturers threatened by the yen's appreciation."[4]

Japanese government officials indicate that MITI's plans for coordinated economic development are not official government policy. Some observers point out that many of the projects outlined by the New AID Plan were never actually funded. Moreover, analysts disagree on the extent to which the government has motivated recent Japanese investment in Southeast Asia. Richard Cronin of the Congressional Research Service noted, "Whether this picture of a strategic plan for

integrating Southeast Asia into the Japanese economy is alarmist or realistic is difficult to answer with any certainty." He further pointed out, "Japanese multinationals and their bureaucratic allies are primarily interested in expanding or maintaining their worldwide market shares, not the creation of a new 'co-prosperity sphere.'"[5]

Japanese Investment in Asean

As of the end of FY 1990 Japan's cumulative investment in Asia represented slightly more than 15 percent of its worldwide foreign direct investment versus about 43 percent in North America and just over 19 percent in Europe. Investment in Asean nations — 8.8 percent of the Japanese total — constituted more than half of Japan's investment in Asia (see Table 1). In 1990 Japan was either the largest or the second-largest winner of new foreign investment approvals for the five biggest Asean nations, according to the U.S.-Asean Council. (Comparable investment data were not available for Brunei.) While two decades ago American investment predominated in Southeast Asia, by 1990 Japan's investment position was roughly twice that of the United States, the U.S.-Asean Council reported.

Table 1: **Japan's Foreign Direct Investment in Asean, FY 1986-FY 1991 First Half**

(in millions of dollars)

	FY 1986	FY 1987	FY 1988	FY 1989	FY 1990	First Half FY 1991	Total September 30, 1991
Brunei	$1	$0	$0	$0	$0	$0	$109
Indonesia	250	545	586	631	1,105	412	11,952
Malaysia	158	163	387	673	725	462	3,694
Philippines	21	72	134	202	258	82	1,662
Singapore	302	494	747	1,902	840	286	6,840
Thailand	124	250	859	1,276	1,154	487	4,910
Total Asean	856	1,524	2,713	4,684	4,082	1,729	29,167

Source: Ministry of Finance

In contrast to Japanese investment in Asean in the 1970s, which was concentrated in natural resource development and labor-intensive manufacturing like textiles, the post-1985 period saw Japanese makers of consumer and other electronics products as well as producers of automotive parts shift assembly of more low-end products to the region. The web of recent investment by Japanese multinationals in Southeast Asia has resulted in what CRS's Mr. Cronin has described as a "regional production base ... involving the manufacture of various components, final assembly and even product design and development across national boundaries in accordance with each country's particular resource endowments, economic infrastructure or labor markets." Mr. Cronin noted that over the long term Japanese economic managers in Asia, "[A]ppear to seek an optimum 'division of labor' that maximizes each country's comparative advantage, thus fostering complementary rather than competitive patterns of industrialization."[6]

Impact of Japanese Investment on Asean Nations

The pattern of economic development in Asia frequently is described as that of "flying geese," where Japan leads a formation of Asian economies in which each gains from the economic and

technological experience of members of the group whose development precedes its own. Some Asean members have made a concerted effort to follow the Japanese model of industrialization. In 1978 Singapore launched an official "Learn from Japan" campaign. In 1982 Malaysia's Prime Minister Mahathir Mohamad announced a "Look East" policy that he described recently as implying "[L]earning the work ethics, management styles and organizations of those countries in the East which were achieving dynamic growth."[7] The Japanese government's policy of cooperating with and encouraging business was a key feature both countries sought to imitate.

While "Look East" still is considered an important Malaysian policy, some analysts have noted that Southeast Asia's embrace of the Japanese model has loosened as nations in the region have realized the differences that separate their societies from Japan's and have reevaluated their image of the Japanese private sector. Moreover, trading partners' accusations that they have adopted Japan's alleged "mercantilist" trade practices also pose a risk for Asean nations. Companies in both the United States and the European Community, for example, have filed dumping and subsidization complaints against items processed in Thailand by Japanese companies or using Japanese components.

Beyond these considerations are certain spin-offs of the Japanese business approach for Asean nations. In theory, for example, the Japanese preference for joint ventures over wholly owned subsidiaries (which U.S. investors tend to favor) allows both parties to an agreement more flexibility and offers greater opportunities for technology transfers. Compared to other foreign investors Japanese businesses are seen as less likely to be frightened off by potential political instability in a host country. Japan's investment insurance coverage has given some Japanese firms the confidence to start operations, since the program takes into account a country's political situation.

Yet some aspects of corporate Japan's management style can be sources of tension for the host nation. Frequently cited examples are the tendency of Japanese companies to keep top management posts in Japanese hands and to transfer technology cautiously, even in joint ventures. Japanese business representatives reportedly counter these complaints by stressing that it takes time for local employees to learn the technology and how a particular company operates. Some also point to the competitive risks inherent in technology transfers. Yet Asean observers say that American and other foreign investors have a better record of training Asean nationals and placing them in management positions.

Japanese firms also have been accused of constricting their affiliates' activities by providing inadequate training and by placing restrictions on exports. In addition, critics have targeted some Japanese manufacturing operations in Asean for substandard working conditions and drastic layoffs. In Malaysia, for example, the grievances of workers in Japanese factories have included poor ventilation, extreme temperatures and exposure to dangerous chemicals. In some Asean nations local retailers and producers complain about being squeezed out of the domestic market by goods produced by Japanese affiliates.

A lack of cultural integration also is a concern among Asean countries where Japanese businesses invest but then appear to remain isolated from the community. A 1991 report of a survey conducted by Keizai Doyukai (Japan Association of Corporate Executives) indicated that, although most Japanese investors recognize this as a problem, they may be slow to address it. The survey of Japanese business representatives in Southeast Asia found that more than 80 percent said they felt they should increase their respect for local culture and customs, yet only 27 percent of those polled said they should contribute more to the local community and only 18 percent said they should promote personal exchanges with nationals.

Further issues that pit the value of investment against societal concerns include worries that Japanese investment will encourage a widening gap between rich and poor. Some Asean political leaders also question the environmental harm to the region from Japanese firms that do not exercise the same safeguards they would at home. Certain Japanese firms, for example, allegedly shifted

processing facilities to Southeast Asia to avoid antipollution pressures in Japan. Malaysia, for one, has indicated that pollution control is a priority and that it will not welcome pollution-causing foreign investment. Moreover, a number of analysts predict that unless the pace of Japanese investment slows, some Asean nations will face serious shortages of skilled labor as well as inflated wages and land prices.

These and other concerns have led Asean countries, as their economies advance, increasingly to press for investment that utilizes and contributes to a skilled labor force as well as expands technological capabilities. Political and business leaders in the region also want investors to improve the infrastructure and to increase access to low-cost financing. These objectives do not always coincide neatly with those of foreign investors. Mr. Cronin of CRS concluded that one source of friction facing Japanese investors and Asian host countries is "the conflict between the drive of Japanese companies to integrate their offshore manufacturing operations on a regional basis, versus the aspirations of many developing countries to maximize their domestic industrial self-sufficiency."[8] Reconciliation of these objectives is hampered, he noted, because Japanese firms probably would not move production overseas if the solution to remaining profitable had been simply to increase investment at home or to develop new products. Moreover, he added, not only do Japanese manufacturers prefer to maintain tight control over their technology, they also tend to continue at their overseas plants their existing relationships with subcontractors and suppliers. In 1988 almost 40 percent of the inputs used by Japanese affiliates producing manufactured goods in Asean nations was sourced from Japan (see Table 2).

Table 2: **Procurement by Asean Affiliates of Japanese Firms, 1988**

	Share of Sourcing From			
	Local	Japan	Asia	Other
Total Industry	43.6%	39.0%	9.3%	8.1%
Manufactured Goods	41.9	39.2	14.8	4.1
Food	98.8	0.8	0.4	0.0
Textiles	39.6	34.3	15.7	10.4
Wood and Pulp	95.8	2.8	0.0	1.4
Chemicals	43.6	23.3	4.4	28.7
Steel	29.4	45.1	17.8	7.7
Nonferrous Metals	54.2	33.3	0.6	11.9
Nonelectric Machinery	49.2	45.6	5.1	0.1
Electric Machinery	32.5	40.3	24.6	2.6
Transport Equipment	39.0	47.3	13.5	0.2
Precision Equipment	7.9	85.0	2.8	4.3
Petroleum and Coal Products	64.4	35.6	0.0	0.0
Others	61.4	23.6	9.3	5.7

Source: Ministry of International Trade and Industry

On a larger scale Asean members have questioned whether their economies will become overly dependent on Japan. Beyond their dissatisfaction with specific Japanese business practices, many Southeast Asian government officials are wary of potential Japanese economic domination in the region. Some stress the need to attract American and European investment to maintain a foreign investment balance. During President Bush's January trip to the region news reports quoted Singapore's Prime Minister Goh Chok Tong as calling for the United States to be a "partner in our economies to help balance the growing presence of Japan."

Other Investment in Asean

Although new Japanese investments have overtaken new American commitments in Asean, the United States still maintains a healthy investment position in the region. American investment there totaled $12.3 billion at yearend 1990, up from $10.2 billion a year earlier. More than half of that money was invested in Singapore and Indonesia. This country traditionally has concentrated much of its Asean investment on the petroleum industry. Between 1985 and 1990, however, U.S. manufacturing investment in Southeast Asia rose 113 percent, while U.S. petroleum investment dropped in most Asean countries. At yearend 1990 the American direct investment position in Asean's manufacturing sector was valued at $4.6 billion, 37 percent of total U.S. investment there.

American businesses, like their Japanese counterparts, have used Asia and the Asean nations, in particular, as production bases. In 1988 about 21 percent of American firms' production took place outside the United States (not specifically in Asia), compared to the roughly 5 percent share of Japanese manufacturers' output that was produced offshore. Also like their Japanese counterparts, American affiliates in many manufacturing industries sell a significant share of their output in local markets. (For a discussion of the export patterns of American and Japanese affiliates in Asia and in general, see *JEI Report* No. 9A, March 6, 1992.) In high technology industries, however, U.S. companies involved in Asia as a whole ship most of their products back to the parent company. This is in contrast to Japanese firms in Asean, which direct most high technology manufactures to other Asian countries or to markets outside the region (see Table 3). For some Asean countries products made by U.S. affiliates represent a significant share of exports to the United States. One economist has estimated, for example, that more than half of Singapore's exports to this country are produced by American subsidiaries there.[9]

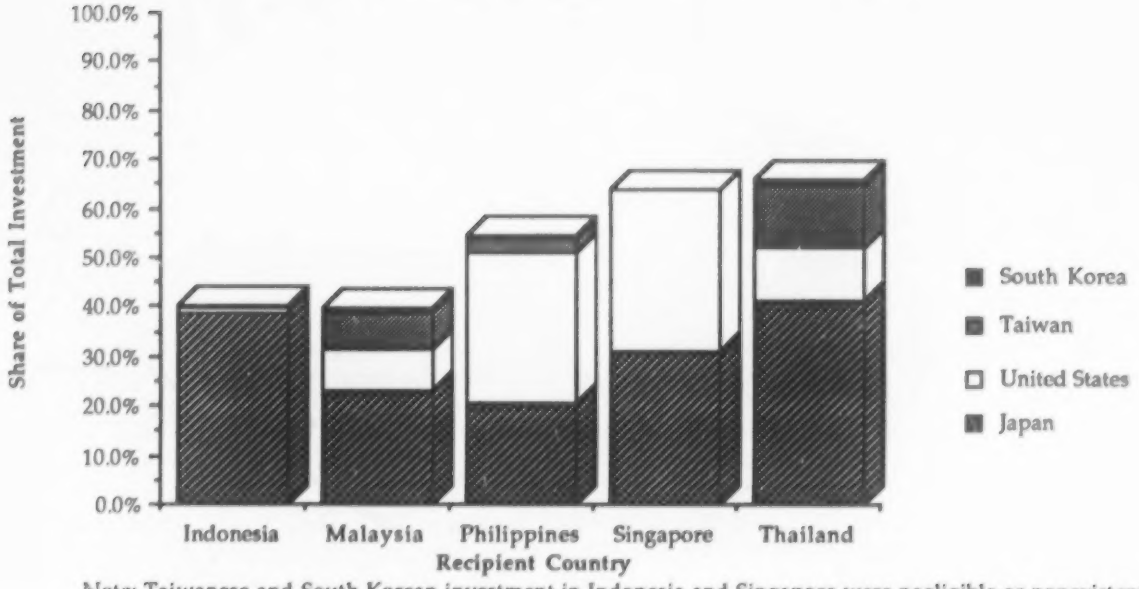
Table 3: **Sales by Asean Affiliates of Japanese Firms, 1988**

	Share of Sales To			
	Local	Japan	Asia	Other
Total Industry	66.9%	10.5%	8.7%	13.9%
Manufactured Goods	61.1	12.5	12.5	13.9
Food	14.4	34.7	27.2	23.7
Textiles	59.3	9.3	11.5	19.9
Wood and Pulp	18.7	46.0	23.8	11.5
Chemicals	91.1	4.4	3.6	0.9
Steel	91.1	5.9	1.4	1.6
Nonferrous Metals	41.3	42.4	8.6	7.7
Nonelectric Machinery	96.8	2.6	0.5	0.1
Electric Machinery	31.6	13.3	26.2	28.9
Transport Equipment	96.8	1.2	1.2	0.8
Precision Instruments	3.3	15.4	41.8	39.5
Petroleum and Coal Products	98.7	0.8	0.2	0.3
Others	81.5	10.2	4.8	3.5

Source: Ministry of International Trade and Industry, 1990

Such intrafirm types of trade flows are expected to shield Singapore from any move toward protectionist policies in this country. Yet Asean as a whole relies heavily on the United States to absorb its exports. These goods are being manufactured not only by American- and Japanese-affiliated firms but increasingly by production facilities owned by other Asian nations. The acceleration of investment from Asia's newly industrialized economies — South Korea, Hong Kong, Taiwan and Singapore — has been one of the most striking investment trends in Asean (see Figures 1 and 2).

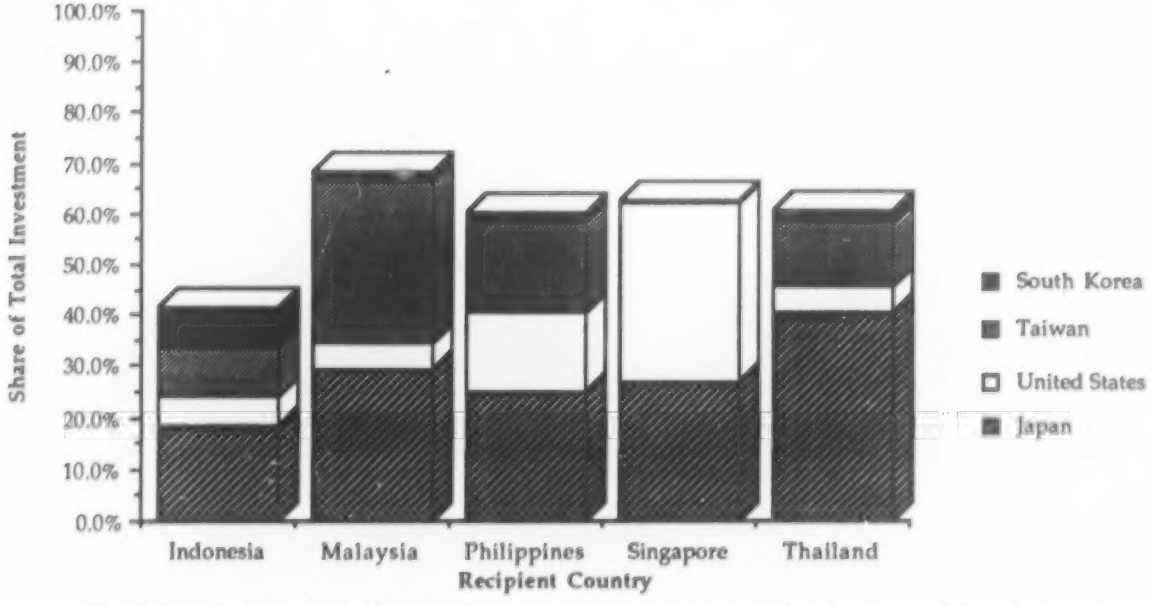
Figure 1: **Foreign Direct Investment in Asean Countries, 1985-87**



Note: Taiwanese and South Korean investment in Indonesia and Singapore were negligible or nonexistent during this period.

Source: Ministry of Finance

Figure 2: **Foreign Direct Investment in Asean Countries, 1988-90**



Note: Taiwanese and South Korean investment in Singapore were negligible or nonexistent during this period.

Source: Ministry of Finance

Ironically, while competition with the NIEs was one factor motivating Japanese firms to move production in the mid-1980s to Southeast Asia for lower-cost labor, among other reasons, the need to remain similarly competitive has compelled Asia's "four tigers" to follow Japan to Asean. Strengthened currencies and trade deficits with the United States have motivated Taiwan and South Korea, in particular, to move production offshore.

Japan's Trade with Asean

In 1991 Japan imported $31.8 billion from Asean compared to the $20.8 billion the United States imported from the region (see Table 4). Yet while manufactured goods represented 68 percent of this country's imports from Asean in 1989 (the latest year for which comparative data are available), only 18 percent of Japan's imports from the region consisted of manufactures (see Figures 3 and 4).

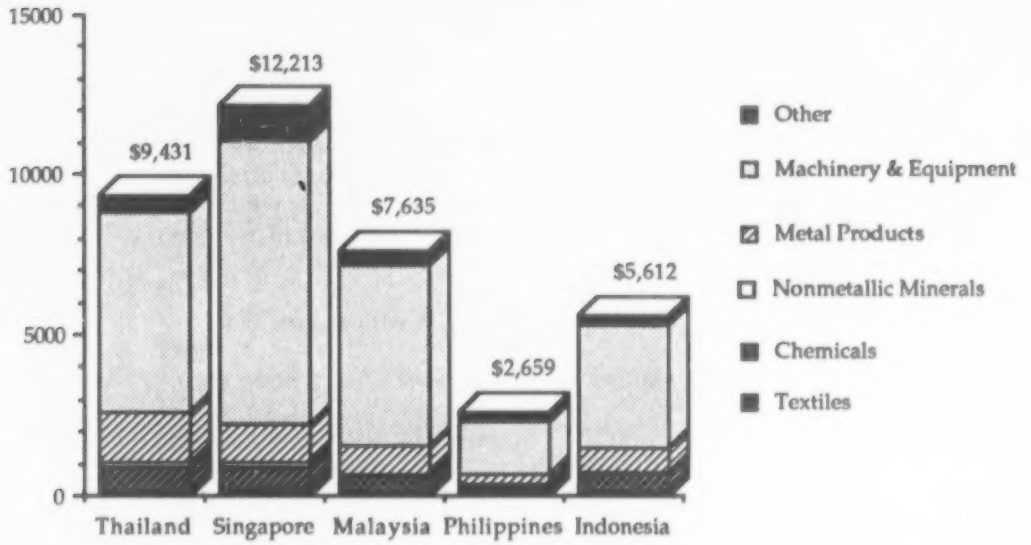
Table 4: **Japan's Trade with Asean, 1987-91**

(in millions of dollars; exports f.o.b., imports c.i.f.)

	1987	1988	1989	1990	1991
Brunei					
Exports	$40	$67	$83	$86	$129
Imports	1,184	1,117	1,086	1,262	1,500
Trade Balance	-1,144	-1,050	-1,003	-1,176	-1,372
Indonesia					
Exports	2,990	3,054	3,301	5,040	5,613
Imports	8,427	9,497	11,021	12,721	12,770
Trade Balance	-5,437	-6,443	-7,720	-7,682	-7,157
Malaysia					
Exports	2,168	3,060	4,124	5,511	7,635
Imports	4,772	4,710	5,107	5,402	6,471
Trade Balance	-2,604	-1,650	-983	110	1,163
Philippines					
Exports	1,415	1,740	2,381	2,504	2,659
Imports	1,353	2,044	2,060	2,157	2,352
Trade Balance	62	-304	321	347	308
Singapore					
Exports	6,008	8,311	9,239	10,708	12,213
Imports	2,048	2,339	2,952	3,571	3,415
Trade Balance	3,961	5,972	6,287	7,137	8,799
Thailand					
Exports	2,953	5,162	6,838	9,126	9,431
Imports	1,796	2,751	3,583	4,147	5,252
Trade Balance	1,157	2,410	3,256	4,979	4,179
Total Asean					
Exports	15,574	21,394	25,966	32,975	37,679
Imports	19,580	22,458	25,809	29,260	31,759
Trade Balance	-4,006	-1,064	157	3,715	5,920

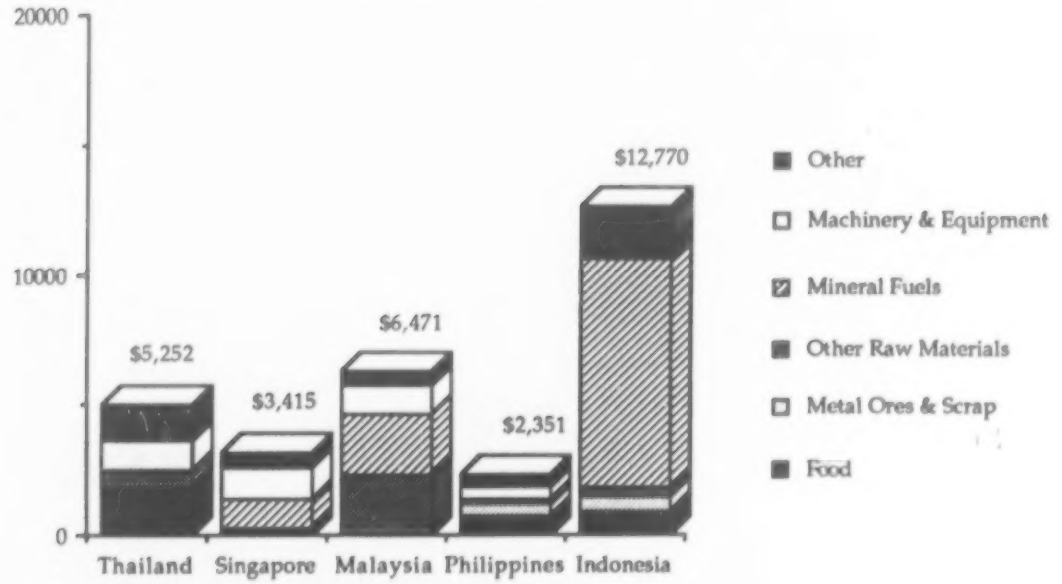
Source: Ministry of Finance

Figure 3: **Japan's Exports to Asean Countries, 1991**
(in millions of dollars)



Note: Figures less than $200 million are not reflected in this graph.
Source: Japan Tariff Association

Figure 4: **Japan's Imports from Asean Countries, 1991**
(in millions of dollars)



Note: Figures less than $200 million are not reflected in this graph.
Source: Japan Tariff Association

Although the share of manufactured products in Japan's imports is approximately double that of 1985, it has not kept up with the dramatic rise in the proportion of Asean exports represented by manufactured goods. Moreover, some analysts have suggested that the cause of the recent decrease in Japan's share of total Asean exports is that country's reluctance to open its market fully to Asean-made manufactured products (see Table 5).

Table 5: **Destination of Asean Exports, 1984 and 1990**

(in millions of dollars)

	1984		1990	
Destination	Amount	Share	Amount	Share
United States	$15,040	19.2%	$27,936	19.8%
Japan	20,556	26.2	26,798	19.0
Other Asean*	16,326	20.8	28,294	20.1
Newly Industrialized Economies	12,731	16.2	25,797	18.3
World Total	78,454	100.0	141,019	100.0

*Part of the Asean total is estimated from import data.

Source: International Monetary Fund, *Direction of Trade Statistics Yearbook 1991.*

Political as well as business leaders in the region fault Japan's private sector for being more interested in buying agricultural and industrial inputs than manufactured products and using nontariff barriers to restrict imports of Asean manufactured goods. Asean observers cite Japan's distribution system and strict import specifications as factors hampering such trade. Moreover, some analysts suspect that items produced in Japanese-owned or Japanese-affiliated companies account for most of the growth in Japanese imports of manufactured goods from Asean nations; local firms reportedly continue to face difficulties exporting their products to Japan. To counter these concerns some Asean leaders have initiated programs to increase Japan's imports of manufactured goods. Indonesia, for example, has restricted the shipment of logs in an effort to promote plywood exports. Suggestions that Japan commit to a "buy-back" arrangement for goods produced by Japanese affiliates in the region have yet to gain momentum. These and other long-standing efforts to change the composition of Japan's imports from the region have resulted in only limited increases, fueling frustration among some Asean policymakers.

Although in some countries the imbalance between Japan's high value-added exports and low value imports has created tension, most Asean leaders discount their countries' current trade deficit with Japan; a number explain the imbalance as a necessary step in building their manufacturing sector. Japan's historical reliance on Asean for primary products meant that prior to the mid-1980s most members maintained a trade surplus with Japan. Since 1985 Asean has increased its imports from Japan significantly, a development many analysts attribute to Japanese investment in the region and the resulting inflow of Japanese capital and intermediate goods. Plant and machinery imports currently adding to Asean trade imbalances are seen as a step toward boosting members' export capacities. Singapore's Deputy Prime Minister Lee Hsien Loong, for example, commented in February that he did not expect his country's growing trade imbalance with Japan to become a political problem and noted that Singapore exports much of what it buys from that country in the form of final products.

Two much-debated plans pose a question of what effect regional trading blocs or some sort of regional trading group would have on Asean trade. One plan to move member nations toward a

common market is seen as the latest step in Asean efforts to boost regional economic coordination and cooperation. Leaders of the six nations agreed in late January to pursue an Asean free trade area (see *JEI Report* No. 5B, Feburary 7, 1992). In part the members took this approach because of other global trade developments, such as the strengthening of the European Community trade bloc and talks to formulate a North American Free Trade Agreement. Some Asean business and political leaders have expressed fears that such regional trade tie-ups could narrow Asean's export opportunities as well as divert foreign investment from Southeast Asia.

Much more caution among regional leaders has greeted the other main proposal for economic collaboration — the East Asia Economic Caucus. Supporters of EAEC have urged the Japanese government to take a lead role in the group, which would unite Asean members plus Japan, the People's Republic of China, Taiwan, Hong Kong, South Korea, Vietnam, Myanmar and Pacific Island nations. Yet Tokyo has indicated that it is not ready to commit to the group, which some people in Japan fear would exacerbate trade tensions between that country and the United States.

One of the likely topics to be addressed as Asean leaders discuss free trade arrangements is rules of origin requirements. The question of local content requirements — frequently debated in the United States and other countries where Japan has a significant manufacturing presence — reportedly has received relatively little attention to date in Asean. This is expected to change, however, as countries try to gain more control over investment in their economies.

Asean as a Market and an Investment Site

Previous efforts to boost intra-Asean trade have had limited success, in large part because the similarity of goods produced by the six nations fostered competition rather than complementary trade. Yet many analysts expect a rapid rise in intraregional trade. This anticipated trend is in part a response to outside developments, particularly the recession affecting many industrialized nations and the inward-looking response to integration in the EC economies. But expanded intraregional trade also reflects an optimistic view of the opportunities offered by the dynamic economies of Asean and the rest of Asia. Asean members' projected growth rates for 1991, among the highest in Asia, underscore the region's attractions for trade and investment.

Many analysts question whether the economic slowdown in Japan in the year ahead will constrain Japanese businesses from investing in and importing from the region. More than a year ago a *Wall Street Journal* poll of Japanese firms with investments in Southeast Asia showed that almost half of the respondents planned to increase their investment in manufacturing or related facilities in the region in 1991. Although a number of respondents attributed plans to boost investment to labor shortages and costs in Japan, almost twice as many cited the "increasing attractiveness of the Southeast Asian market."[10] New Japanese investment commitments in Southeast Asia dropped significantly in the first half of FY 1991 compared to the previous year in line with the general trend of capital outflows from Japan. Some economists suggest, however, that competitive factors and the extent to which Japan has integrated production in the region will prevent Japan from reducing its investments in Asean and the rest of Asia.[11]

Citing reasons other than internal economic belt-tightening, Bank of Tokyo analysts have surmised that capital flows to Southeast Asia have slowed largely because Japanese and other foreign investors have finished most of their overseas expansion plans. Other observers have attributed the slowdown in part to the inability of most nations in the region to absorb further foreign investment. Inadequate infrastructure and an anticipated labor crunch are seen as problems for potential investors. In addition, Asean leaders wary of economic overheating appear to be pursuing foreign investment with greater care. Analysts caution that competition from Eastern Europe and Latin America for investor financing means that Asian nations will have to put more effort into enhancing their investment climate through such measures as clamping down on inflation, controlling deficits, removing protectionist barriers and deregulating their economies.

Another factor Japanese investors are likely to consider is the political stability of Asean nations, many of which face anticipated leadership changes in the next couple of years. In Indonesia parliamentary elections scheduled for this spring are expected to be followed by the 1993 return of President Suharto for his sixth term in office. The winning party in Thailand's March elections will take a lead role in forming that country's new government. Increased political instability could threaten the Philippines if May's presidential contest among a number of contenders results in the election of someone with only narrow popular backing.

Outlook for Japan's Political Role in the Region

Many Asean leaders recognize that Japan's economic standing in Southeast Asia carries with it a larger political role in the region, and some appear to be giving Tokyo cautious encouragement to pursue such leadership. Yet Asean observers emphasize that the six member nations intend to play a part in defining this role. Hadi Soesastro, executive director of Indonesia's Center for Strategic and International Studies, has cautioned, "All of us must come together and agree on the role we should give Japan before Japan plays that role."[12] Asean's determination not to cede decisions about a forum for security discussions, for example, was reflected in its initially hesitant response to Tokyo's July 1991 proposal that the group formalize annual ministerial meetings with "dialogue partners," including Japan, for this purpose. To a certain extent worries about a potential Japanese military presence continue to color some perceptions of Tokyo's role in the region.

Despite the concern mentioned in Singapore and the Philippines, among others, about a proposal that would allow Japan to send military units abroad to participate in United Nations-sponsored peacekeeping efforts, the thought of Japan playing a larger economic role in the region generally is accepted. One observer noted that within Asia, "Asean is the most at ease with Japan as an economic superpower and the least worried about Japan's desire to play a greater political role."[13]

Many in Asean look to Japan, in fact, to lead efforts aimed at strengthening regional economic cooperation and to represent their interests in broader discussions, including those of the Group of Seven industrialized nations. In late February Singapore's Deputy Prime Minister Lee announced that Asean would invite Japan's Minister of International Trade and Industry for discussions with the group following its annual economic meeting this year. Asean economic ministers have held similar discussions with Washington, but the invitation is a first for Tokyo and was described by Mr. Lee as "a useful step forward" for Asean.

The positive economic impact of Japanese aid, investment and trade in Asean appears to have outweighed the six nations' concerns about some aspects of Japan's involvement in the region. Yet as their interdependence in these areas evolves, both Japan and the six Asean members are likely to be challenged by new expectations and demands.

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Notes

[1]Paul Blustein, "Japan's 'Asian Bloc': More Illusion Than Reality," *The Washington Post*, December 8, 1991, p. H5.

[2]Testimony of Kevin Kearns, Economic Strategy Institute, before the Senate Finance Committee, subcommittee on international trade, April 15, 1991.

[3]Policy speech by Prime Minister Toshiki Kaifu, Singapore, May 3, 1991, *Asean Economic Bulletin*, July 1991, p. 90.

[4]David Arase, "U.S. and Asean Perceptions of Japan's Role in the Asian-Pacific Region" in Harry Kendall and Clara Joewono (eds.), *Japan, ASEAN, and the United States* (Berkeley, California: Institute of East Asian Studies, University of California at Berkeley, 1991), p. 270.

[5]Richard Cronin, *Japan's Expanding Role and Influence in the Asia-Pacific Region: Implications for U.S. Interests and Policy* (Congressional Research Report for Congress), September 7, 1990, pp. 23-24.

[6]*Ibid*, pp. 8, 21.

[7]Ai Leng Choo and Nayan Chanda, "Prime Minister of Malaysia Criticizes Western Model for Economic Growth," *The Wall Street Journal*, September 30, 1991.

[8]Cronin, *op.cit.*, p. 47.

[9]Chia Yew Boon, Crosby Securities Pte. Ltd., cited in Steven Levingston, "Asian Export Growth Fueled by New Markets," *The Asian Wall Street Journal*, October 21, 1991, p. 4.

[10]Masayoshi Kanabayashi and Urban Lehner, "Tokyo Investment Shift May Spur Economic Gains in Southeast Asia," *The Wall Street Journal*, January 14, 1991, p. A9B.

[11]See, for example, Raphael Pura, "Slumps in U.S. and Europe Test Asia's Ability to Adapt Policies to Slower Economic Climate," *Asian Wall Street Journal*, January 27, 1992, p. 3.

[12]Siti Rahil Dollah, "Asean More Receptive to Political Role for Japan," *The Japan Times*, July 11, 1990, p. 3.

[13]Susumu Awanohara, "Apology Signals Break with Past," *Far Eastern Economic Review*, June 20, 1991, p. 47.

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The views expressed in this report are those of the author and do not necessarily represent those of the Japan Economic Institute.